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**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

The Honorable Governor and Honorable Members of the State Legislature
State of Delaware, Department of Transportation
Dover, Delaware:

We have audited the financial statements of the State of Delaware Department of Transportation (the Department) as of and for the year ended June 30, 2007, and have issued our report thereon dated October 12, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Delaware Department of Transportation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting as items 2007-1, 2007-2, 2007-3, and 2007-4.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be



material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Department in a separate letter dated October 12, 2007.

The Department's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State of Delaware Secretary of Transportation, management, Office of the Governor, Attorney General, Comptroller General, Office of Management and Budget, Department of Finance and the U.S. Department of Transportation and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 12, 2007

STATE OF DELAWARE DEPARTMENT OF TRANSPORTATION

Schedule of Findings and Responses

Year ended June 30, 2007

2007-1. Accounting for Capital Assets and Infrastructure

Observation

In order to calculate the ending capital asset balances for the Department's financial statements, the Department uses various spreadsheets as well as expense reports from its general ledger system to calculate the balance of capital assets and infrastructure, the Department does not current have a capital asset subsidiary ledger that can roll-forward all of the elements typically contained in capital asset records, including identification, location, historical cost, acquisition date, useful life, depreciation, accumulated depreciation, and funding source.

The application of the modified approach to infrastructure requires determining if capital program expenditures are for preservation and maintenance or additions to the capacity of infrastructure. The Department currently has a sub-appropriation code in its general ledger system that tracks infrastructure additions so expenses can be coded correctly when they relate to infrastructure, however this coding has been inconsistently applied. The result is that projects are reviewed at year-end to determine whether they are capacity-building and there are no clear procedures surrounding this review.

Recommendation

In the prior year, we recommended that the balances of capital asset infrastructure be centrally managed in a capital assets subsidiary ledger with the capability to track additions, deletions and calculate depreciation.

We further recommended that the Department establish clear guidelines and procedures for determining whether a project adds capacity for purposes of financial reporting when a project is established, rather than at each year-end, so that capacity-building expenditures can be readily identified for financial reporting purposes.

The Department is in the process of developing a policy to address these recommendations, however these recommendations had not been implemented as of June 30, 2007. We continue to recommend that the Department both develop a capital asset subsidiary ledger and establish clear guidelines and procedures for determining whether a project adds capacity for purposes of financial reporting when a project is established.

Management's Response

DelDOT's BACIS accounting system does not have a centrally managed fixed asset subsidiary ledger and one is not anticipated to be established, inasmuch as the BACIS accounting system is over 25 years old. DelDOT is not upgrading BACIS due to the fact that the State is implementing a new accounting system to be operational by July 2009, which DelDOT will be using. These issues should be addressed in this new Peoplesoft system.

As far as determining whether or not a project adds capacity for purposes of financial reporting, DelDOT has prepared a draft "Infrastructure Project Classification Policy," the Department will move to formally establish the policy and distribute it throughout the Department by December 31, 2007.

STATE OF DELAWARE DEPARTMENT OF TRANSPORTATION

Schedule of Findings and Responses

Year ended June 30, 2007

2007-2. Nonroutine Transactions

Observation

We recommended in the prior year that the Department establish a formal review process over contracts entered into by the Department affecting revenue for the purpose of determining accounting treatment for year-end financial reporting. Although the Department implemented policies to perform such reviews going forward in response to this recommendation, contracts that were executed prior to this fiscal year may also have continuing impact on revenue.

In the current year, the Department received \$5.5 million in payment for the sale of land. We recommended, and management recorded, an audit adjustment to appropriately reflect the transaction on the Department's financial statements.

Recommendation

We recommend that, in addition to the contract review for new contracts, the Department also establish a formal review process for significant nonroutine transactions for the purpose of determining appropriate accounting treatment.

Management's Response

A formal policy to review all contracts resulting in funds received by the Department was implemented during fiscal year 2007. As part of the policy all significant nonroutine transactions resulting in revenue are also being reviewed to insure proper accounting treatment.

STATE OF DELAWARE DEPARTMENT OF TRANSPORTATION

Schedule of Findings and Responses

Year ended June 30, 2007

2007-3. Financial Reporting

Observation

The Department has contracted for the past several years with an outside CPA firm to compile its financial statements for the Transportation Trust Fund, Delaware Transit Corporation, and for the consolidated Delaware Department of Transportation entity.

The process used to obtain the necessary information for balances outside of the Department Trust Fund is not clearly documented, does not occur on a clear timetable, and relies heavily on one individual to provide information requested by the contractor for compilation purposes. Financial statement items impacted include receivables, payables, and capital assets, including infrastructure assets.

Additionally, there is no independent review of the information for completeness, accuracy, and conformity with generally accepted accounting principles prior to its being provided to the contractor, increasing the risk of potential undetected misstatements, errors, or omissions.

Recommendation

We recommend that the Department develop, for the 2008 audit cycle:

- A detailed list of balances (other than those in the Transportation Trust Fund and Delaware Transit Corporation) and what detailed reports, supporting schedules, and other documentation are needed to support the compilation of financial statements and disclosures related to those balances
- A specific timetable of when each of the detailed reports, supporting schedules, and other documentation will be completed
- Interim review process to evaluate data before year end to identify any issues and correct them before year end close
- A periodic monitoring process to ensure the timetable is adhered to.

We further recommend that the Department consider whether the current level of staffing is appropriate to:

- Disperse responsibility for specific reports, schedules and documentation to others within the accounting function
- Provide for an independent review of information for completeness, accuracy and conformity with generally accepted accounting principles prior to its receipt by the compilation contractor
- Review data throughout the year for completeness and accuracy.

Management's Response

The Department of Transportation prepares its financial information based on GAAP guidelines issued by the State Division of Accounting. The Department will make an effort to better define the data collection process and timelines applicable to same. While we currently monitor financial data periodically, we will endeavor to expand that process to a wider range of data in the future and will review that data throughout the year for correctness and accuracy. Also with the implementation of the State's new peoplesoft financial system, in July 2009, we believe many of these issues will be resolved.

STATE OF DELAWARE DEPARTMENT OF TRANSPORTATION

Schedule of Findings and Responses

Year ended June 30, 2007

2007-4. Change Control over Toll System Host Computer

Observation

The toll system host computer and related software is used to process, record and reconcile over \$128 million in toll revenue from both cash and EZ Pass customers.

There are four toll system software support positions, all of which have the ability to develop changes to the toll system and the ability to migrate them into the production environment. Typically, such duties are segregated to mitigate the risk that changes are disruptive to system operations either intentionally or unintentionally.

Although there is a change management policy requiring review and approval of changes, the ability exists to circumvent the approval process because of the lack of segregation of duties.

Recommendation

We recommend that the development of system changes be segregated from the ability to migrate changes into production.

Management's Response

Existing policies are currently being modified to ensure adequate segregation of duties. The current Change Policy and Request form will also be modified to manage, approve and track all system changes. All changes are scheduled to be implemented by January 1, 2008.